

Exiting Difficult Trusts

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“Hope is a talent like any other” Storm Jameson

Trustees sometimes get trapped in trusteeships. Sometimes there is a relationship breakdown with the beneficiaries, other times the trustee is exiting the trust business, and other times still the trustee decides that a given trust no longer fits its risk profile.

Changes of trustee are usually incident free but problems can arise when a sole trustee is unable to find a replacement. As a trust is not a separate legal entity the idea of a sole trustee simply retiring without a replacement is fraught with difficulty.

There are many reasons why replacement trustees can be hard to find. With older trusts, a new trustee might struggle to satisfy increasingly stringent due diligence requirements. Fee pressure from the family may mean that what they are willing to pay is below market rate and consequently a new trustee cannot be found. In other cases still the appointment of a new trustee might require, within the trust deed, the consent of a protector, which consent is not forthcoming.

A trustee desiring to exit a trusteeship has 2 high level options: retire as trustee, or distribute the trust fund.

If a Trustee wishes to retire there are three main options for a successor: another institutional trust company; named individuals (possibly family members); or a private trust company (PTC).

Increasingly trust companies are turning to the final option. In many cases trustees will have an express or implied power to use part of the trust fund to set up and register a PTC, which can then take over from them as trustee of the trust. This means that the trustee *creates* its own successor and then retires in favour of it, eliminating the problem of *finding* a successor.

This option is not a panacea. The PTC needs to have directors to operate it, and the ownership of the PTC needs to be considered. Trusted advisors of the beneficiary family may be willing to be appointed to the PTC board and PTC ownership can be structured through a purpose trust, to avoid succession issues.

Retirement in favour of a PTC also creates indemnity issues for the retiring trustee. On retirement the retiring trustee typically parts with the trust fund, in exchange for a contractual indemnity from the new trustee. Where the new trustee is a PTC (by its nature unlikely to have any significant assets, except for the trust fund) the retiring trustee's contractual indemnity from the new trustee is of limited value. To resolve the problem, the retiring trustee often seeks indemnities from others, or otherwise looks for ways to protect its position (such as taking security over trust assets, or retaining part of the trust fund for a given period after retirement).

If retiring in favour of a new trustee is not viable the alternative is to distribute the trust fund. In some cases the trustee will have discretion to appoint the trust fund to any beneficiary of the trust. If the trustee has the power to do this without the need for third party consent, it may take a view that it is appropriate to pay the trust fund to a beneficiary. By decanting the trust fund to beneficiaries the trust ends by operation of law and the trustee ceases to act as trustee.

To assess the viability of this option, the trustee needs to consider the trust deed: What distributive powers does the trustee possess? Are third party consents needed to exercise those powers? If a proposed distribution is *formally* within the scope of the trustee's powers (ie: if what is proposed can, on a literal interpretation of the power, be achieved by its exercise), is it *appropriate* for the trustee to exercise the power in that way?

If a power is formally wide enough to permit a proposed distribution, it is important that the trustee makes the decision for the right reason and not simply because it wants to retire. A trustee is a fiduciary and has to put its duty to the beneficiaries above its own interests, where those two come into conflict.

When exercising its discretion, the trustee must exercise its own discretion in good faith, only within the scope of the terms of the relevant power, and only for purposes for which the discretions were conferred on it. The trustee also needs to act responsibly, in a properly informed fashion, taking account of relevant matters and ignoring irrelevant matters.

Unless the trustee complies with these requirements any exercise of its discretion might be capable of challenge in the courts. If a trustee wants further assurance it is possible to obtain the court's "blessing" of a decision, before the trustee makes the distribution. In the Cayman Islands, a trustee can make an application to the courts under section 48 of the Trusts Law. Other trust jurisdictions have equivalent procedures.

The Cayman Islands courts have shown themselves willing to bless "momentous" decisions. The factors taken into account by the court in blessing applications are complicated but, in short, the

court will be reluctant to refuse a blessing provided that the decision was reached in good faith, that it is not unreasonable, and that a conflict on the part of the trustee did not affect its decision.

Judges are usually sympathetic to the plight of trustees in these circumstances. Often the fact that the trustee is unable to retire without court involvement is due to a general breakdown in the relationship with the beneficiaries. The trustee might be struggling to get information on the trust fund, to exercise its powers appropriately and in the interests of the beneficiaries, or to comply with the trust's tax reporting obligations (because information about the whereabouts of the beneficiaries is not forthcoming). If a blessing application is made on this wider basis, the court will usually be motivated to find a solution and will appreciate that the status quo is unsustainable.

With a little creative thinking, there is always hope.

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